

Accountability Audit Report

Eastern Washington State Historical Society

(Northwest Museum of Arts and Culture)

For the period July 1, 2016 through June 30, 2017

Published July 12, 2018 Report No. 1021710





Office of the Washington State Auditor Pat McCarthy

July 12, 2018

Wesley Jessup, Director Northwest Museum of Arts and Culture Spokane, Washington

Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The State Auditor's Office takes seriously our role of providing state and local governments with assurance and accountability as the independent auditor of public accounts. In this way, we strive to help government work better, cost less, deliver higher value and earn greater public trust.

Independent audits provide essential accountability and transparency for Museum operations. This information is valuable to management, the governing body and public stakeholders when assessing the government's stewardship of public resources.

The attached comprises our independent audit report on the Museum's compliance with applicable requirements and safeguarding of public resources for the areas we examined. We appreciate the opportunity to work with your staff and we value your cooperation during the audit.

Sincerely,

Pat McCarthy

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State Auditor

Olympia, WA

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AUDIT RESULTS

This report describes the overall results and conclusions for the areas we examined. In most of the areas we examined, except as described below, Museum operations complied with applicable state laws, regulations, and its own policies, and provided adequate controls over safeguarding of public resources.

As referenced above and described in the attached finding, we identified areas in which the Museum could make improvements.

We recommend the Museum improve its processes for procuring and managing contracts. Specifically, the Museum should:

- Establish internal policies and procedures related to contracting
- Designate a contract manager to coordinate and oversee procurement and monitoring activities.
- Track all active contracts
- Ensure staff complete required training courses

We also recommend the Museum improve its internal controls over processing donations. Specifically, the Museum should:

- Deposit all money designated for the Museum into the Museum's bank account
- Establish adequate internal controls to better safeguard and account for donations

These recommendations were included with our report and in a separate communication as findings.

We also noted certain matters that we communicated to Museum management in a letter dated June 26, 2018, related to vendor payments, travel, and the Director's compensation. We appreciate the Musuem's commitment to resolving those matters.

About the audit

This report contains the results of our independent accountability audit of the Northwest Museum of Arts and Culture from July 1, 2016 through June 30, 2017.

Management is responsible for ensuring compliance and adequate safeguarding of public resources from fraud, loss or abuse. This includes the design, implementation and maintenance of internal controls relevant to these objectives.

This audit was conducted under the authority of RCW 43.09.310, which requires the Office of the State Auditor to examine the financial affairs of all state agencies. Our audit involved performing procedures to obtain evidence about the Museum's use of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters.

In keeping with general auditing practices, we do not examine every transaction, activity or area. Instead, based on our risk assessment for the year ended June 30, 2017, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance.

The following areas were examined during this audit period:

- Cash receipting
- Procurement and monitoring of contracts
- Collection of and accounting for donations
- Vendor payments
- Director's compensation
- Payments for employee travel
- Employee use of purchase cards

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2017-001 The Eastern Washington State Historical Society did not comply with procurement laws or required state policies and did not perform adequate contract monitoring.

Background

The Eastern Washington State Historical Society, known to the public as the Northwest Museum of Arts and Culture (Museum), contracts with exhibition companies and other vendors to carry out its mission to engage people in the appreciation of arts and culture through collections, stewardship, exhibits and programs that educate and entertain.

The Department of Enterprise Services (DES) is responsible for the development and oversight of policies that govern how state agencies contract for goods and services. State law authorizes agencies to purchase goods and services up to a cost of \$10,000 (excluding sales tax) directly from a vendor without soliciting for bids through a competitive process.

DES also establishes policies that delegate purchasing authority to state agencies. The Museum was given delegated authority of up to \$50,000 for goods, services and IT purchases. The Museum must satisfy all applicable Washington requirements when conducting procurements within its delegated authority. State agency employees who initiate, manage, monitor or work on contracts must attend training courses provided by DES.

The Museum spent \$1,660,232 on goods and services in fiscal year 2017, which accounted for 34 percent of its total spending.

Description of Condition

The Museum did not comply with procurement laws or required state policies and did not perform adequate contract monitoring. We found the Museum did not establish a process to track its contract activities and could not provide a list of active contracts and information about what it paid to contracted vendors in fiscal year 2017.

We analyzed the Museum's accounting records and interviewed staff to identify purchased services that warranted a contract being in place. We found the following issues:

Compliance with procurement requirements

We examined contracts with seven vendors executed during state fiscal year 2017 and found that the Museum:

- Paid five vendors \$187,145 without having executed contracts in place. The amount paid to these vendors exceeded the direct-buy limit.
 - One vendor, which was paid \$84,362, exceeded the Museum's delegated procurement authority of \$50,000.
- Established two contracts with the same vendor, for the same services, that were not competitively procured. The total amount paid to the vendor exceeded the direct-buy limit by \$815.
- Did not post four sole source contracts in the state's contract database or the state vendor registration and bid notification system.

Contract payments

We examined payments made to vendors totaling \$452,461 and found that the Museum:

- Did not have supporting documentation to show whether services were received for \$23,226 in payments
- Paid \$38,081 for vendor travel reimbursements. Of this amount, \$280 was overpaid and \$13,780 was not supported by receipts or invoices.
- Paid a vendor for hotel rooms for seven of its employees; the contract specified that the Museum would pay only for up to six employees.

Compliance with training requirements

We reviewed contract training records for Museum employees and found:

- The Interim Executive Director had not taken required training courses, but had executed all the contracts we reviewed.
- Thirty employees did not attend a required State Purchasing and Procurement Ethics class.

Cause of Condition

The following internal control weaknesses caused the Museum's lack of compliance with state procurement law:

- The Museum did not establish internal policies and procedures for contract procurement, management, or monitoring.
- The Museum did not have a designated contract manager.

- Management was unfamiliar with required DES policies.
- Staff responsible for executing contracts did not negotiate the terms and conditions to ensure the contract language specified the Museum's responsibilities.
- The Museum did not monitor staff to ensure employees completed required training courses.

Effect of Condition

The Museum cannot ensure it receives the best value for goods and services purchased with state funds when it does not follow DES procurement requirements.

When staff who work with contracts have not taken the required contract training appropriate for their duties, the Museum faces increased risk of violating state law and required policies.

Recommendation

We recommend the Museum:

- Establish internal policies and procedures related to contracting
- Designate a contract manager to coordinate and oversee procurement and monitoring activities. The Museum could choose to delegate this responsibility to department directors if adequate monitoring is implemented by management.
- Track all active contracts
- Ensure staff complete required contract training courses

Museum's Response

The Eastern Washington State Historical Society (EWSHS) concurs with this finding. EWSHS management welcomes the opportunities for improvement that the Accountability Audit has highlighted.

In response to this audit finding, EWSHS will take the following steps to strengthen its compliance with state policies:

- 1. Appoint a contracts manager and more effectively monitor contracts
- 2. Create a monitoring system that tracks employee training
- 3. Establish internal policies and procedures relating to contracting

Auditor's Concluding Remarks

We appreciate the Museum's commitment to resolving these matters. We will follow-up to assess whether it implemented adequate corrective actions in our next audit.

Applicable Laws and Regulations

The Revised Code of Washington 39.26.120 states:

Competitive Solicitation

- (1) Insofar as practicable, all purchases of or contracts for goods and services must be based on a competitive solicitation process. This process may include electronic or web-based solicitations, bids, and signatures. This requirement also applies to procurement of goods and services executed by agencies under delegated authority granted in accordance with RCW 39.26.090 or under RCW 28B.10.029.
- (2) Subsection (1) of this section applies to contract amendments that substantially change the scope of work of the original contract or substantially increase the value of the original contract.

The Revised Code of Washington 39.26.140 states:

Sole Source Contracts

- (1) Agencies must submit sole source contracts to the department and make the contracts available for public inspection not less than ten working days before the proposed starting date of the contract. Agencies must provide documented justification for sole source contracts to the department when the contract is submitted, and must include evidence that the agency posted the contract opportunity at a minimum on the state's enterprise vendor registration and bid notification system.
- (2) The department must approve sole source contracts before any such contract becomes binding and before any services may be performed or goods provided under the contract. These requirements shall also apply to all sole source contracts except as otherwise exempted by the director.

The Revised Code of Washington 39.26.150 states:

Public notice—Posting on enterprise vendor registration and bid notification system.

- (1) Agencies must provide public notice for all competitive solicitations. Agencies must post all contract opportunities on the state's enterprise vendor registration and bid notification system. In addition, agencies may notify contractors and potential bidders by sending notices by mail, electronic transmission, newspaper advertisements, or other means as may be appropriate.
- (2) Agencies should try to anticipate changes in a requirement before the bid submittal date and to provide reasonable notice to all prospective bidders of any resulting modification or cancellation. If, in the opinion of the agency, it is not possible to provide reasonable notice, the submittal date for receipt of bids may be postponed and all bidders notified.

The Revised Code of Washington 39.26.110 states, in part:

Training:

(3) Beginning July 1, 2013, state agencies must require agency employees responsible for developing, executing, or managing procurements or contracts, or both, to complete department-approved training or certification programs, or both. Beginning July 1, 2015, no agency employee may execute or manage contracts unless the employee has met the training or certification requirements or both as set by the department. Any request for exception to this requirement must be submitted to the director for approval before the employee or group of employees executes or manages contracts.

Department of Enterprise Services Policy #090-00 states, in part:

5) Additional Requirements

- 2) Agencies must satisfy all applicable Washington State procurement requirements when conducting procurements within their delegated authority.
- 4) Agencies must notify DES in advance regarding procurements that may exceed the agency's delegated authority. DES will consult

with the agency to determine whether to conduct the procurement, monitor the agency conducting the procurement or delegate full authority to the agency to conduct the procurement.

Department of Enterprise Services Policy #125-03 states, in part:

4) Additional Requirements:

- 3) Unless otherwise exempt, procurements that exceed the direct buy limit must be competitively awarded, unless otherwise exempt from competition.
- 4) Agencies may not unbundle or manipulate a purchase to have the purchase qualify as a direct buy procurement to avoid using a competitive process.

The Office of Financial Management's State Administrative and Accounting Manual (SAAM) states in part:

20.15.10 Internal control definition

Internal control is a process, effected by those charged with governance, management, and other employees, designed to provide reasonable assurance regarding the achievement of the entity's objectives relating to operations, reporting, and compliance. For purposes of Chapter 20, the state's internal control objectives are defined as the need for each agency to:

- Safeguard its assets.
- Check the accuracy and reliability of its accounting data.
- Promote operational efficiency.
- Encourage adherence to policies for accounting and financial controls.

The definition of internal control emphasizes that internal control is:

- Geared to the achievement of objectives in one or more separate but overlapping categories operations, reporting, and compliance.
- A process consisting of ongoing tasks and activities a means to an end, not an end in itself.
- Effected by people not merely about policy and procedure manuals, systems, and forms, but about

- people and the actions they take at every level of an organization to effect internal control.
- Able to provide reasonable assurance but not absolute assurance, to an entity's management.
- Adaptable to the entity structure or size flexible in application for the entire entity or for a subset of an entity.

This definition of internal control is intentionally broad. It incorporates concepts that are fundamental to how entities design, implement, and operate a system of internal control and assess its effectiveness.

20.15.20 Roles and Responsibilities:

Agency management is responsible for the agency's operations, compliance and financial reporting objectives. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management. That said, every state employee has a role in effecting internal control. Roles vary in responsibility and level of involvement, as discussed below.

Given agency structure and size, individuals may assume multiple roles. However, care should be taken to address the increased risk that may result from the concentration of responsibilities.

20.15.20.a

Those charged with governance are responsible for overseeing the strategic direction of the agency and obligations related to the agency's accountability. This includes overseeing the design, implementation, and operation of an effective internal control system. For most agencies, those charged with governance include the agency head and members of agency senior management. For agencies with a governing board, the board may appoint individuals to fulfill this function.

20.15.20.b

The agency head is ultimately responsible for identifying risks and establishing, maintaining, and monitoring the agency's system of internal control. If the agency head delegates this responsibility, the

designated person should have sufficient authority to carry out these responsibilities. The agency head together with those charged with governance and agency management set the tone at the top that affects the control environment in particular and all other components of internal control. The agency head signs the annual Financial Disclosure Certification and, if applicable, the Federal Assistance Certification.

20.15.20.c

The internal control officer (ICO) is responsible for coordinating the agency-wide effort of evaluating internal control using the guidance in this chapter. The ICO coordinates the agency's required risk assessment and internal control monitoring activities and annually provides written assurance to the agency head as required in Subsection 20.15.30. While each agency is required to have an ICO, the ICO may perform these duties on a full-time basis or on a part-time basis as long as other duties performed are not incompatible with the ICO duties.

20.15.20.d

Agency management at all levels is responsible for internal control under their span of control. Management is responsible to communicate to agency employees their explicit or implicit control activity duties. In addition, agency management should provide channels outside normal reporting lines so agency employees can report noncompliance, problems in operations, and illegal acts.

Management is also responsible to convey the importance of internal control to all employees both by what they say and what they do. If management is willing to override controls, then the message that internal control is not important will be conveyed to employees.

20.24.10 Control activities overview:

Control activities are policies, procedures, techniques, and mechanisms that help ensure that risks to the achievement of an agency's objectives are mitigated. Control activities are performed at all levels of the agency, at various stages within business processes, and over the technology environment. They may be preventive or detective in nature. Preventive controls are designed

to deter the occurrence of an undesirable event by implementing procedures to avoid them. Detective controls are designed to identify undesirable events that do occur and alert management about what has happened.

When designing and implementing control activities, management should consider cost versus benefit and the likelihood and impact of the associated risk. Building control activities into business processes and systems as they are being designed is generally more cost-effective than adding them later.

20.28.10 Monitoring overview:

Monitoring is the process of evaluating the quality of internal control performance over time and promptly addressing internal control deficiencies. Monitoring can take the form of ongoing evaluations, which are built into business processes at different levels of the agency, or separate evaluations, which are conducted periodically and vary in scope and frequency, depending on assessment of risks, effectiveness of ongoing evaluations, and other management considerations.

Monitoring of the internal control system is essential in helping internal control remain aligned with changing objectives, environment, laws, resources, and risks.

20.28.30 Monitoring versus control activities:

It can be difficult to distinguish between a review that is a control activity and one that is a monitoring activity. Some judgment is involved but determining the intent of the activity can help. An activity designed to detect and correct errors is likely a control activity, while an activity designed to ask why there were errors in the first place and assign responsibility for fixing the process to prevent future errors is likely a monitoring activity. In other words, a control activity responds to a specific risk, while a monitoring activity assesses whether controls within each of the five components of internal control are operating as intended.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2017-002 The Eastern Washington State Historical Society did not have adequate internal controls in place to ensure donations were properly deposited and accounted for.

Background

About the Museum

The Eastern Washington State Historical Society, also known as the Northwest Museum of Arts & Culture (Museum), engages people in the appreciation of arts and culture through collections, stewardship, exhibits and programs that educate and entertain.

The Museum is a state agency that must follow state laws, rules and policies. State law allows the Museum to accept donations and membership fees. The Museum is governed by a Board of Trustees (Board), which is responsible for adopting rules that govern and protect the receipt and expenditure of all donations and ensure funds are used according to donor intent.

About the Foundation

The Northwest Museum of Arts & Culture Foundation (Foundation) was created to help provide operating funds for the Museum. The Foundation may also receive donations to be used as the donor specifies. The Foundation is not a state agency and therefore not required to comply with the same laws, regulations and state policies that govern the Museum.

The Museum and the Foundation are both registered with the Secretary of State as tax-exempt, non-profit organizations.

Donations for both the Museum and the Foundation are receipted by Museum staff and deposited in local bank accounts. State rules require donations designated for the Museum to be deposited in the Museum's bank account. Museum staff receive donations through various methods, with the most popular method being checks delivered directly to the Museum. The donations delivered to the Museum are recorded on a log by an employee who designates what account to deposit them in. The Museum's fiscal analyst then electronically deposits all checks into the corresponding bank account.

When the Museum receives donations designated for the Foundation, they are to be deposited in the Foundation account. If it is unclear whether a gift was intended to

be given to the Museum or to the Foundation, staff contact the donor to obtain clarification about their intent and process the donation accordingly.

Donations and memberships received by both the Museum and the Foundation totaled \$1,362,636 in fiscal year 2017.

Description of Condition

We found the Museum did not establish adequate internal controls to ensure donations were properly deposited and accounted for.

We examined donations and memberships totaling \$337,840 to determine if they were receipted and deposited according to state rules. We found:

- \$176,054 (52 percent) of donations were designated for the Museum, but were deposited into the Foundation's account.
- \$115,861 (34 percent) of donations were not supported by adequate documentation, such as copies of checks, to verify who they were made payable to or the donor's intent.

Cause of Condition

The Museum said that it has been a past practice to receipt and deposit all donations into the Foundation's account.

The Museum had no written policies or procedures over the process used for receipting donations.

Effect of Condition

When donations designated for the Museum are not deposited into the Museum account, the Museum cannot ensure it receives all funds to which it is entitled. Because of this, the Museum does not have all funds readily available to cover operating expenditures. The Museum is also at a higher risk for misusing public funds if donations are not used according to donor intent and state law.

Recommendation

We recommend the Museum:

- Deposit all money designated for the Museum into the Museum's bank account
- Establish adequate internal controls to better safeguard and account for donations. For example:
 - Develop written policies and procedures over the donation receipting process

- Perform a supervisory review over receipted donations
- Perform a reconciliation to ensure all donations are accounted for

Museum's Response

The Eastern Washington State Historical Society (EWSHS) concurs with this finding.

EWSHS management welcomes the opportunity for improvement that the Accountability Audit has highlighted. It should be noted that substantial improvement has been made in EWSHS' compliance since the last agency audit, which occurred in early 2016. EWSHS is committed to continuing to improve its compliance and performance.

As the audit recommended, EWSHS will establish clear written policies and procedures around the accepting of gifts and the documenting of donor intent. EWSHS will also perform periodic supervisory reviews over receipted donations and will regularly reconcile donations and the restricted bank account to ensure all donations are accounted for.

Auditor's Concluding Remarks

We appreciate the Museum's commitment to resolving these matters. We will follow-up to assess whether it implemented adequate corrective actions in our next audit.

Applicable Laws and Regulations

Revised Code of Washington 27.34.070 states, in part:

State historical societies—Powers and duties.

- (1) Each state historical society is designated a trustee for the state whose powers and duties include but are not limited to the following:
 - (h) To accept gifts, grants, conveyances, bequests, and devises, of real or personal property, or both, in trust or otherwise, and sell, lease, exchange, invest, or expend the same or the proceeds, rents, profits, and income therefrom except as limited by the donor's terms. The governing boards of the state historical societies shall adopt rules to govern and protect the receipt and expenditure of the proceeds, rents, profits, and income of all such gifts, grants, conveyances, bequests, and devises;

Washington Administrative Code 256-30-030 states, in part:

Procedures for accepting gifts.

(2) Donor intent: Society staff and representatives agree to respect and carry out the intentions of the donors whose gifts, grants, conveyances, bequests, or devises have been accepted by the society or the foundation on behalf of the society.

Washington Administrative Code 256-30-050 states, in part:

Donations to the society.

- (1) When the society receives a donation, it shall comply with all the rules and regulations related to gift giving for gifts it receives directly. Those rules are found in state, federal and corporate law related to:
 - (a) State entities and public 501 (c)(3) corporations;
 - (b) Federal and state laws and regulations that apply to the society as a 501 (c)(3) corporation including, but not limited to, the U.S. Internal Revenue Service Code; and
 - (c) Professional standards of ethical and donor-centered fund-raising.
- (2) The society cannot have ownership in stocks nor can it make gifts of public funds.
- (3) Private funds donated directly to the society shall be held consistent with all state rules and regulations governing expenditure of those funds.
- (4) Restricted funds shall be kept in a separate line account as nonlapsing funds of the society together with earned interest and shall be used in accordance with the directions provided by the donor.
- (5) Unrestricted funds shall be retained in a separate line account of the society as nonlapsing funds. Disbursement shall be made by the executive director in accordance with policy established by the board of trustees or in consultation with the board of trustees.

Washington Administrative Code 256-30-060 states:

Donations to the Northwest Museum of Arts and Culture Foundation.

The northwest museum of arts and culture foundation, a separate 501 (c)(3) corporation was incorporated for the purpose of providing funds to support the operations and programs of the society. If the society receives any donations designated for the foundation, those donations shall be delivered to the foundation as soon as possible. All gifts designated for the society shall be retained by the society consistent with these regulations. If it is unclear whether a gift was intended to be given to the foundation or to the society, the society shall clarify the donor's intent and handle the donation consistently.

Affiliation Agreement between the Eastern Washington State Historical Society (dba) Northwest Museum of Arts and Culture and the Northwest Museum of Arts and Culture Foundation states, in part:

I. Foundation Role and Responsibility

C. 6. The Foundation agrees to tend to the Society immediately all donations it may receive wherein the donor names the Society as the recipient, and to be responsible for and accounted for in its own records all donations wherein the donor names the Foundation as recipient.

C. 8. Accept any gifts and grants and deposit them in the Foundation or distribute them to the Society in accordance with "Guidelines for Establishing and Disbursing Funds by the Foundation," which is attached hereto as Exhibit "A" and incorporated herein."

INFORMATION ABOUT THE MUSEUM

The Eastern Washington State Historical Society was founded in 1916. In 1926, the state Legislature designated the Museum as a trustee for materials of historical significance to the state. The Museum's mission is to promote learning about regional history, visual arts and American Indian and other cultures, especially those specific to the region. To carry out this mission, the Museum does business as the Northwest Museum of Arts and Culture.

The Museum is composed of the Cheney Cowles Center, an exhibit and education building, and the historic Campbell House and Carriage House on a five-acre campus in Spokane's historic Browne's Addition. Currently, the Museum has more than 100,000 visitors and raises approximately \$1.5 million each year through various exhibitions, activities and fundraising events. The Museum operates on an annual operating budget of approximately \$3.5 million.

The Museum has 39 employees and approximately 2,600 members. The Board of Trustees consists of a maximum of 25 members elected for three-year terms by the Museum membership. The Board elects a President to a two-year term and the remaining officers to a one-year term.

Contact information related to this report		
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Information current as of report publish date.

Audit history

You can find current and past audit reports for the Northwest Museum of Arts and Culture at http://portal.sao.wa.gov/ReportSearch.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as <u>fraud</u>, state <u>whistleblower</u> and <u>citizen hotline</u> investigations.

The results of our work are widely distributed through a variety of reports, which are available on our <u>website</u> and through our free, electronic <u>subscription</u> service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

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